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NOTES

Cash Tender Offers: Judicial Interpretation of Section 14(e)

IN THE PAST FIFTEEN YEARS, the frequency of corporate takeover attempts in the form of cash tender offers has increased dramatically.[1] During most of this period, cash tender offers were outside the scope of the federal securities laws. It was not until 1968 that Congress amended the Securities Exchange Act of 1934[2] by passing the Williams Act[3] for the express purpose of placing the cash tender offer under federal regulation.[4] Section 14(e),[5] the antifraud provision of the Williams Act, has been much litigated in the short time since its passage,[6] and the meaning of the section is slowly being clarified.

This note is an analysis of a recent case from the Second Circuit Court of Appeals, *Chris-Craft Industries, Inc. v. Piper Aircraft Corp.*,[7] the leading case on section 14(e), and of its ramifications concerning

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[1] In 1960 there were only eight cash tender offers involving companies listed on national securities exchanges, whereas in 1966 there were over one hundred such offers. 2 U.S. CODE CONG. & AD. NEWS 2811, at 2812 (1968) [Hereinafter referred to as 2 U.S. CODE NEWS].

[2] 15 U.S.C. §§ 78a-hh (1970) [Securities Exchange Act of 1934 hereinafter referred to as the 1934 Act].

[3] Pub. L. No. 90-439, 82 Stat. 454 (1968), *amending* 15 U.S.C. §§ 78m-n (1964) (codified at 15 U.S.C. §§ 78m(d)-(e), n(d)-(f) (1970)) [Hereinafter referred to as the 1968 amendments, the Williams Act, or the Act].

[4] The purpose of the legislation as originally proposed by Senator Williams in 1965 was to protect incumbent management from "corporate raiders." By the time of introduction of S.B. 510, which eventually was enacted as P.L. 90-439, he had recognized the desirability of permitting corporate takeovers as an aid in eliminating inefficient management. Hamilton, *Some Reflections on Cash Tender Offer Legislation,* 15 N.Y.L.F. 269, 275 (1969).

[5] 15 U.S.C. § 78n(e) (1970).

[6] *See, e.g.,* Sonesta Int'l Hotels Corp. v. Wellington Associates, 483 F.2d 247 (2d Cir. 1973); Electronic Specialty Co. v. International Controls Corp., 409 F.2d 937 (2d Cir. 1969); Fabrikant v. Jacobellis, CCH Fed. Sec. L. Rep. ¶ 92,686 (E.D.N.Y. 1970); Neuman v. Electronic Specialty Co., CCH Fed. Sec. L. Rep. ¶ 92,591 (N.D. Ill. 1969).

[7] 480 F.2d 341 (2d Cir.), *cert. denied,* 414 U.S. 910 (1973).

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cash tender offers. The first part will treat cash tender offers and the legislation passed in 1968 in general, and the second part, *Chris-Craft* and its ramifications.

Cash Tender Offers

The tender offer has been defined as a:

> . . . public offer or solicitation by a company, an individual, or a group of persons to purchase during a fixed period of time all or a portion of a class or classes of securities of a publicly held corporation at a specified price or upon specified terms for cash and/or securities.[8]

A tender offer normally involves two corporate parties, the tender offeror[9] and the target corporation,[10] as well as the shareholders of the target corporation. The purpose behind the tender offer is to acquire sufficient shares of the target from the target's shareholders to enable the tender offeror to take control of the target. In comparison with other methods of corporate acquisition, the cash tender offer presents a number of distinct advantages.[11] A tender offer can often be much less costly than a merger or a sale of assets. Since the tender offeror need only pay for the number of shares required for control, the predominant cost of a tender offer is the premium paid above the market price.[12] In a merger or sale of assets, on the other hand, the

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[8] Aranow & Einhorn, *Essential Ingredients of the Cash Tender Invitation,* 27 BUS. LAW. 415 (1972). *But see* Note, *The Developing Meaning of "Tender Offer" Under the Securities Exchange Act of 1934,* 86 HARV. L. REV. 1250 (1973), wherein the relatively recent expansion of the term "tender offer" is set out.

[9] A tender offeror is one who seeks to acquire control of a corporation through a tender offer. The fundamental mechanics of a tender offer are described in Sowards & Moksky, *Corporate Take-Over Bids: Gap in Federal Securities Regulation,* 41 ST. JOHN'S L. REV. 499, 502 (1967):

> The mechanics of the take over bid are simple. Typically X, the person seeking to acquire control, or X's agent, will make an offer by newspaper advertisement to purchase for cash a certain number of shares of Y corporation at a fixed price that is set above the current market price. Y corporation shareholders are invited to tender their shares for purchase by X or X's agent. More specifically, Y corporation shareholders who wish to accept the offer are instructed (1) to send a "letter of transmittal", accompanied by their stock certificates in transferable form, to X or X's agent, or (2) to request their bank or broker to effect the tender transaction for them. A date and hour for termination of the purchase offer are stated.

The tender offeror is likely to be a glamour company, one whose price to earnings ratio is exceptionally high as a result of its attraction to the public. Cohen, *Tender Offers and Takeover Bids,* 23 BUS. LAW. 611 (1968).

[10] A target corporation is the object a tender offeror seeks to aquire through his tender offer. The target is not likely to be a glamour girl, but rather a wall flower, a company whose stocks, not currently in public favor, have a low price-to-earnings ratio. Cohen, *supra* note 9.

[11] *See generally* Fleischer and Mundheim, *Corporate Acquisition by Tender Offer,* 115 U. PA. L. REV. 317, 318-21 (1967); Note, *Cash Tender Offers,* 83 HARV. L. REV. 377, 378-79 (1969).

[12] *See* Note, *Tender Offers: The Liberalization of Standing Requirements under Section 14(e),* 7 U. SAN. FR. L. REV. 561 (1973).

purchasing company would normally pay for all of the target's assets.[13] Perhaps most important is the fact that the incumbent management of the target must agree to a merger, or a sale of its assets.[14] Thus, if management opposes such a takeover, the only resort is to a proxy contest. But the poor likelihood of success coupled with the slim prospects for recovery of expenses, together suggest that a proxy contest might better be avoided.[15]

There are two basic types of tender offers.[16] The cash tender offer is a simple cash-for-stock transaction with the offeror paying cash for the stock of the target corporation. The exchange tender offer is an exchange of stock of the offeror for stock of the target. Before the 1968 amendments, the latter was seldom used because of the requirement that a registration statement be filed with and declared effective by the Securities and Exchange Commission (SEC).[17] Indeed, prior to the 1968 amendments, most securities lawyers agreed that in a contested takeover situation a cash offer was mandatory for success, whereas a stock exchange offer had much less chance of success.[18]

In sharp contrast to the regulation of an exchange offer, before the 1968 amendments, cash tender offers were subject to little legal control.[19] The majority of tender offer suits were brought under section 10(b)[20] and its implementing SEC rule 10b-5.[21] The courts generally employed one of two theories in deciding these cases. The first was that a private suit under rule 10b-5 had to be brought by a purchaser or seller, and since neither nontendering shareholders nor target corporations are purchasers or sellers, they generally could not sue.[22]

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[13] Fleischer & Mundheim, *supra* note 11, at 318.

[14] *Id.*

[15] *See* Aranow & Einhorn, *supra* note 8; Note, *Judical Enforcement of the Williams Amendments,* 27 BUS. LAW. 391, 392 n. 3 (1972); Note, *Cash Tender Offers, supra* note 11, at 379.

[16] The term "tender offer", as such, is misleading, in its place a new term has been suggested, "tender request". Note, *The Developing Meaning of "Tender Offer" Under the Securities Exchange Act of 1934, supra* note 8, at 1251 n. 7.

[17] A stock exchange is considered an issuance of securities; and the offeror must file a registration statement with the SEC, which must make the statement effective before the exchange can take place. Securities Act of 1933, §§ 5-8, 10, 15 U.S.C. §§ 77e-h, j (1970).

[18] Wander, *Selecting Targets and Shaping Strategy in Corporate Take-Overs; Securities Law — Considerations,* 24 SW. L.J. 593, 594 (1970).

[19] *See generally* 6 Loss, *Securities Regulation* 3620-24 (Supp. 1969); Note, *Cash Tender Offers, supra* note 11, at 380; Note, *Tender Offers: The Liberalization of Standing, supra* note 12, at 562-64.

[20] 15 U.S.C. § 78j(b) (1970).

[21] 17 C.F.R. § 240.10b-5 (1973).

[22] *See, e.g.,* Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir.), *cert. denied,* 343 U.S. 956 (1952) (rule 10b-5 extends protection only to defrauded purchasers or sellers). *But cf.* Vine v. Beneficial Finance Co., 374 F.2d 627, 634 (2d Cir.), *cert. denied,* 389 U.S. 970 (1967) (nontendering plaintiff found to be forced seller and therefore

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The second was that offerors, as outsiders, had no duty to disclose non-inside information; hence, there was no liability for failure to do so.[23] It was to close this gap in the federal securities laws that Congress enacted the 1968 amendments to the 1934 Act.[24]

The amendments result in broad regulation of various areas of the tender offer proceeding.[25] In general, they provide for the filing of a statement with the SEC, the target, and any exchange trading in the target's securities before an offer is made.[26] The offeror must include in the statement his identity and background, the source and amount of funds to be used in payment for tendered securities, any plans or proposals for major changes in the structure of the target corporation, the number of shares of the target corporation presently owned, and the details of any arrangements with others concerning the acquired securities.[27] In addition, the amendments regulate the mechanics of cash tender offers to some degree,[28] and give the SEC rulemaking authority both to modify the statement requirements[29] and to regulate countersolicitations[30] and stock repurchases by management.[31]

While it is true that these provisions went far toward providing full and fair disclosure of relevant information for the benefit of the public investor, perhaps the most significant provision of Public Law 90-439 is section 14(e), the antifraud provision:

(Continued from preceding page)

within the *Birnbaum* doctrine); Mutual Shares Corp. v. Genesco, Inc., 384 F.2d 540 (2d Cir. 1967) (plaintiff given injunctive relief despite the fact that purchases were prior to the violations in question). But Iroquois Indus., Inc. v. Syracuse China Corp., 417 F.2d 963 (2d Cir. 1969), *cert denied,* 399 U.S. 909 (1970) again upheld the vitality of *Birnbaum* and limited its exceptions to their facts.

[23] *See* Mills v. Sarjem Corp., 133 F.Supp. 753, 765 (D.N.J. 1955) (outsider has no duty to disclose information to stockholder to whom offer was made); *cf.* Mutual Shares Corp. v. Genesco, Inc., 384 F.2d 540, 545 (2d Cir. 1967) (outsider has no duty to disclose information to stockholders to whom he makes no offer; but court indicated no opinion concerning duty to stockholders to whom offer made).

[24] 2 U.S. CODE NEWS, *supra* note 1, at 2814.

[25] *See generally* Note, *Cash Tender Offers, supra* note 11, at 381-88.

[26] 1934 Act § 14(d), 15 U.S.C. § 78n(d) (1970).

[27] 1934 Act § 13(d), 15 U.S.C. § 78m(d) (1970), incorporated into § 14(d), 15 U.S.C. § 78n(d) (1970).

[28] 1934 Act § 14(d)(5), 15 U.S.C. § 78n(d)(5) (1970) (provides securities deposited for purpose of tendering can be withdrawn within seven days of offer or after sixty days from offer); 1934 Act § 14(d)(6), 15 U.S.C. § 78n(d)(6) (1970) (provides for pro rata purchase of shares tendered in first ten days of offer if less than all shares are to be purchased); 1934 Act § 14(d)(7), 15 U.S.C. § 78n(d)(7) (1970) (provides that if consideration is increased during offer, all shareholders who tender, whether before or after increase, shall be paid the increase). *See also* Hamilton, *supra* note 4, at 285-89.

[29] 1934 Act § 14(d)(1), 15 U.S.C. § 78n(d)(1) (1970).

[30] 1934 Act § 14(d)(4), 15 U.S.C. § 78n(d)(4) (1970).

[31] 1934 Act § 13(e)(1), 15 U.S.C. § 78m(e)(1) (1970).

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> It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation.[32]

A number of cases have been decided on the basis of section 14(e); the courts have settled some questions while raising others.[33] The most recent of these cases, and certainly the most far-reaching, is *Chris-Craft Industries, Inc. v. Piper Aircraft Corp.*[34]

Chris-Craft

Chris-Craft is the major appellate decision under section 14(e) of the 1968 amendments. The court, in an opinion written by Judge Timbers, reviewed a consolidated appeal of three related lower court decisions[35] involving a contest for control of the Piper Aircraft Corporation (Piper). The court discussed the application of section 14(e) to the issues of standing to sue, violations, causation, and the appropriate relief to be granted.

Factual Setting

In early 1969, Chris-Craft Industries (CCI) had made a cash tender offer to Piper shareholders which Piper management, essentially the Piper family, opposed. Piper, in letters to its shareholders, recommended rejection of the CCI offer, stating that it was "convinced that it [the offer] is inadequate and not in the best interests of Piper's shareholders."[36] Piper later issued a press release announcing an agreement to sell 300,000 unissued Piper shares to Grumman Aircraft

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[32] 15 U.S.C. § 78n(e) (1970).

[33] *See, e.g.*, Electronic Specialty Co. v. International Controls Corp., 409 F.2d 937 (2d Cir. 1969); H. K. Porter Co., Inc. v. Nicholson File Co., 353 F.Supp. 153 (D.R.I. 1972), *aff'd*, 482 F.2d 421 (1st Cir. 1973); Dyer v. Eastern Trust and Banking Co., 336 F.Supp. 890 (N.D. Me. 1971); Fabrikant v. Jacobellis, CCH Fed. Sec. L. Rep. ¶ 92,686 (E.D.N.Y. 1970); Neuman v. Electronic Specialty Co., CCH Fed Sec. Rep. ¶ 92,591 (N.D. Ill. 1969).

[34] 480 F.2d 341 (2d Cir.), *cert. denied,* 414 U.S. 910 (1973).

[35] The three appeals were from: 1. a dismissal by the district court of Chris-Craft's complaint against all defendants on grounds that the alleged violations had either not been proven or those that had been had not caused plaintiff any harm, Chris-Craft Industries, Inc. v. Piper Aircraft Corp., 337 F.Supp. 1128 (S.D.N.Y. 1971); 2. The dismissal by the same court of Bangor Punta's complaints against Christ-Craft on grounds of lack of evidence of securities laws violations and of injury to Bangor Punta, Bangor Punta Corp. v. Chris-Craft Industries, Inc., 337 F.Supp. 1147 (S.D.N.Y. 1971); 3. a denial, again by the same court, of a permanent injunction against further violations by Bangor Punta sought by the SEC, S.E.C. v. Bangor Punta Corp., 331 F.Supp. 1154 (S.D.N.Y. 1971).

[36] 480 F.2d at 351.

Company (Grumman). Part of the agreement left unmentioned was an option in Grumman to "put" the shares back to Piper for costs plus interest if a proposed merger did not materialize.[37] Piper eventually supported a competing exchange tender offer by Bangor Punta Corporation (BPC). Both Piper and BPC announced BPC's acquisition of the Piper family shares in Piper and an exchange offer of BPC securities valued at $80 per share to the remaining shareholders. A further agreement — that if the value of the securities received by the Piper family was less than $80 on the opening day of the exchange offer, BPC would make up the difference — went unannounced.[38] In addition, BPC failed to include in its registration statement information concerning its negotiations for the sale of its subsidiary, the Bangor and Aroostook Railroad (BAR), at a price substantially below the value carried on its books.[39] In the meantime, BPC continued to make purchases of Piper stock during the pendency of its exchange tender offer, a further violation of the securities laws.[40] The culmination of these events was the withdrawal of CCI from the contest, having spent over $44 million in cash and securities in a losing effort, and the eventual acquisition by BPC of 51% of the Piper stock.[41]

An action was brought in May, 1969 by CCI alleging violations of various federal securities laws including rule 10b-5 and section 14(e) by defendants Piper, BPC, First Boston Corporation (First Boston) which was acting as BPC's underwriter, and various officers and employees of each. CCI had originally sought damages and equitable relief, but the affirmance on appeal of the district court's denial of a preliminary injunction left only the question of damages to be considered on remand.[42] The district court subsequently dismissed CCI's complaint, and an appeal followed.[43]

The Second Circuit Court of Appeals, in an opinion written by Judge Timbers, held: 1. that CCI, as an unsucessful contestant in a tender offer contest, had standing under section 14(e) to sue defendants for damages; 2. that the actions of defendants amounted to violations of section 14(e); 3. that the conduct of the defendants in violation of section 14(e) caused injury to CCI for which it was entitled to be compensated.

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[37] This arrangement was conditioned on the new shares being listed by the New York Stock Exchange; when listing was refused, the agreement was terminated. *Id.* at 351-52.

[38] *Id.* at 353.

[39] *Id.* at 367.

[40] The court (*Id.* at 378) held this to be a violation of Rule 10b-6, 17 C.F.R. § 240.10b-6 (1973).

[41] *Id.* at 354.

[42] Chris-Craft Indus., Inc. v. Bangor Punta Corp., 426 F.2d 569 (2d Cir. 1970), *aff'g* 303 F.Supp. 191 (S.D.N.Y. 1969).

[43] Chris-Craft Indus., Inc. v. Piper Aircraft Corp., 337 F.Supp. 1128 (S.D.N.Y. 1971).

Judge Mansfield, in a concurring and dissenting opinion, concurred in the results reached by Judge Timbers as to the liability of the defendants, with the exception of the Piper family, whose actions, he felt, had not caused any damage to CCI. Judge Mansfield further dissented as to Judge Timbers' analysis of the issues of scienter and reliance.

Standing

Judge Timbers in his opinion initially focused on the meaning of *J. I. Case Co. v. Borak*[44] as it applies to a private action for violations of the federal securities laws. He alluded to the recognition by the Supreme Court that private actions for damages are a necessary adjunct to SEC enforcement of the federal securities laws. He then noted the congressional purpose behind the enaction of the antifraud provisions was to protect the public investor and to ensure the integrity and efficiency of the securities markets.[45] Thus, the interests at stake make the encouragement of private damage actions to implement the enforcement of the federal securities laws essential.

The legislative history of section 14(e)[46] was next cited, together with *H. K. Porter Co., Inc. v. Nicholson File Co.,*[47] to demonstrate that section 14(e) was meant to make the antifraud proscriptions of the federal securities laws directly applicable to tender offers. The conclusion followed that section 14(e), rather than section 10(b) and rule 10b-5, provided the appropriate basis for CCI's standing to sue.[48]

The application of fundamental logic to the question will yield a similar conclusion. Rule 10b-5 already covered purchases and sales of stock generally, including tender offers, but a right of action under it is limited to the purchasers and sellers. If section 14(e) is to have any meaning whatsoever, it must either supplement or supplant the application of 10b-5. At first glance one would expect the former, but, as will be seen, the court went on to show that section 14(e) is little more than a replica of parts of rule 10b-5, without the disabling purchaser-seller limitation. For this reason, in a practical sense, section 14(e) supplants rule 10b-5 as it applies to tender offers, and, as Judge Timbers observed, provides the appropriate basis for CCI's standing to sue.

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[44] 377 U.S. 426, 430-31 (1964). In *Borak* the Court found that private suits are permissible under § 27 of the 1934 Act for violations of § 14(a).

[45] 480 F.2d at 357.

[46] *See* 2 U.S. CODE NEWS, *supra* note 1, at 2821.

[47] 353 F.Supp. 153 (D.R.I. 1972), *aff'd,* 482 F.2d 421 (1st Cir. 1973). "The plain language of § 14(e), as well as its legislative history, indicate that a tender offeror has standing to seek damages for misrepresentations made by the target corporation."

[48] 480 F.2d at 359.

Judge Timbers then raised the question of CCI's standing to sue for the alleged violations of section 14(e). In holding that CCI had standing to sue, he divided the issue into several subissues. Unfortunately, his failure to distinguish effectively among them left the holding fraught with needless complexity. He first determined that CCI had standing to sue in the constitutional sense.[49] This was based on the rationale that CCI had " 'a personal stake in the outcome of the controversy,' because it has suffered a pecuniary loss directly attributable to defendants' acts."[50] As Judge Mansfield noted in his concurring and dissenting opinion, standing in the constitutional sense was hardly the issue.[51] In spite of this, an evocation of the concept was helpful, if only to distinguish it from the problem of statutory construction.

Treatment was next accorded the second subissue: whether a private right of action existed under federal law. In the determination that CCI had a private right of action for damages, several cases previously decided by the Second Circuit were cited. In *Electronic Specialty Co. v. International Controls Corp.*,[52] a target corporation and a nontendering shareholder were held to have standing under section 14(e) to seek a preliminary injunction against a tender offeror. In *Butler Aviation International, Inc. v. Comprehensive Designers, Inc.*,[53] a target corporation was again held to have standing to seek a preliminary injunction against a tender offeror. Furthermore, dicta in two cases had suggested that section 14(e) might provide standing to a tender offeror against a target corporation.[54] The common law

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[49] The court addressed itself to the question of whether CCI had "such a personal stake in the outcome of the controversy as to assure that concrete adverseness . . . upon which the court . . . depends . . . ." *Id.* at 359 n. 11, *quoting* Flast v. Cohen, 392 U.S. 83, 99 (1968), *quoting in turn* Baker v. Carr, 369 U.S. 186, 204 (1962).

[50] 480 F.2d at 359, *quoting in part* Baker v. Carr, 369 U.S. 186, 204 (1962).

[51] 480 F.2d at 396, Judge Mansfield suggested that the question of standing in the constitutional sense could be settled by a reference to the Supreme Court's decision in Association of Data Processing Serv. Organizations, Inc. v. Camp, 397 U.S. 150, 153 (1970). There the Court said that the question of standing concerns "the question whether the interest sought to be protected by the complainant is arguably within the zone of interests to be protected or regulated by the statute . . . ." This is, in essence, what Judge Timbers referred to in his statements.

[52] 409 F.2d 937 (2d Cir. 1969).

[53] 425 F.2d 842 (2d Cir. 1970).

[54] In Crane Co. v. Westinghouse Air Brake Co., 419 F.2d 787 (2d Cir. 1969), *cert. denied,* 400 U.S. 822 (1970), a case similar to *Chris-Craft* in the reaction by the target company; Crane had atempted a merger with Air Brake, which was rebuffed by incumbent management. Air Brake executed a number of defensive maneuvers to prevent Crane from getting control, and they eventually settled on a strategic retreat — a merger with American Standard. Before voting on the merger could take place Crane made a tender offer to the shareholders of Air Brake of stock and debentures worth $50 in exchange for Air Brake stock, which was then selling at $49. The last day of the tender offer was critical for Crane, since shareholders were waiting to see how high the stock would go before making their decision. On this last day the stock opened at 45¼, but quickly rose to over 50, thus defeating Crane's tender offer. The court found that defendant Standard was responsible for the stock rise due to its market manipulation of buying large blocks of stock on the last day of the offer. The court felt that Crane had standing to sue on the

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tort principle of interference with a "prospective advantage" was then suggested as a possible means whereby CCI could obtain relief in the state courts as an injured party where the means of interference adopted were unlawful. Judge Timbers surmised that the existence of such a claim under common law, coupled with the silence of the federal statute on the subject, was sufficient reason for assuming that Congress had no intention of denying a federal remedy.[55] Judge Timbers then offered the following synthesis. Citing the legislative history of the 1968 amendments, he noted that "the focus of legislative interest was on the public shareholder."[56] From this, he ascertained the general objective of the statute — "to encourage extensive and accurate disclosure of information relevant to a tender offer."[57] Referring to the holding of the Supreme Court in *Borak,* he observed that a private right of action should be implied when it would further the general objective of the securities laws involved. He then concluded that the most reliable way to effectuate the general objective of section 14(e) is to grant standing to sue to the victim of violations of the statute.[58] With a final reference to common law principles of tort, Judge Timbers determined that CCI was such a victim, and therefore had a private right of action for damages.

Interspersed throughout this reasoning was a third subissue — whether CCI was protected by the statute and would therefore have a claim for compensatory damages.[59] It would seem that the decision that CCI was a victim of violations of the statute and, therefore, would have standing to sue carried with it an implication that CCI was also protected under the statute. Judge Timbers offered a further rationale for this implication when he echoed Judge Friendly's opinion in *Electronic Specialty:*

(*Continued from preceding page*)

forced seller rationale under rule 10b-5 since Crane was forced to divest itself of all stock in Air Brake because Standard was a competitor, and owning stock in Standard violated the anti-trust laws. The court also observed in dicta that, although § 14(e) became effective subsequent to the events of the case, it would "serve to resolve any doubts about standing in the tender offer cases. . . ." Crane Co. v. Westinghouse Air Brake Co., *supra* at 798-99. In Iroquois Industries, Inc. v. Syracuse China Corp., 417 F.2d 963 (2d Cir. 1969), the court held that a tender offeror did not have standing to sue target management, which had alledgedly fraudulently persuaded the shareholders to sell their shares to management rather than the offeror. While the court's rationale for not granting standing — because the plaintiff was not a purchaser or seller of securities — is disheartening, it did indicate in dicta that, had § 14(e) been applicable, standing would have been granted. Iroquois Indus., Inc. v. Syracuse China Corp., *supra* at 969-70.

[55] 480 F.2d at 361.

[56] *Id.*

[57] *Id.*

[58] *Id.*

[59] The problem of compensatory damages as proper relief under § 14(e) in an action by a tender offeror against a target corporation had not been dealt with before by this court. It was necessary to determine whether CCI had standing to sue because its interests are protected under the statute, or whether CCI had standing to sue on behalf of those whose interests were protected. In the latter case compensatory damages would not normally be proper relief. *Id.* at 360 n. 12.

> Since Rule 10b-5 covers all types of exchange offers, the major contribution provided by section 14(e) would appear to be a broader standing to sue — accorded both to the offeror and to the opposition — based on fraudulent securities transactions.[60]

He thus reasoned that although it was not explicitly indicated by Congress, a broader class than just shareholders of the target were entitled to the protection of the statute.[61]

Judge Timbers took a number of circuitous routes to arrive at his conclusions. In so doing, he strained his reasoning beyond what was required. His reliance on the common law tort principle of interference with a "prospective advantage" to determine the victim of a 14(e) violation, and to justify inferring a federal remedy for such a violation, was both confusing and probably unnecessary. He seemed to be looking ahead to his ruling on the question of relief and fashioning his standing rationale around his decision on the measure of damages.[62] On the one hand, the rationale is applicable to the determination of a victim, since it is unlikely that a tender offeror will be bringing an action under 14(e) wherein he will not also, in effect, be alleging tortious interference with his attempted tender offer. On the other hand, however, the fact that conduct is tortious and that a remedy for it is found in the state courts, does not imply that a similar remedy exists, or even should exist, in the federal courts.[63]

Judge Mansfield felt that it would be sufficient to analogize section 14(e) to rule 10b-5. He noted that neither section 10(b) nor rule 10b-5 expressly confers the right to sue on purchasers, sellers, or exchangers of securities, yet their implied standing to sue has long since been accepted. He therefore concluded from the *Borak* rationale, that a similar implication of a private right of action under section 14(e) was required.[64] This treatment avoided the complexity found in the majority opinion without sacrificing the broad private action-enforcement rationale which was at the heart of the concept.

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[60] *Id.* at 361.

[61] The court cited Dyer v. Eastern Trust & Banking Co., 336 F.Supp. 890, 914 (D. Me. 1971), as support for its conclusion. In *Dyer* the court denied defendant offeror's motion to dismiss on the grounds that plaintiff shareholders of the offeror were within the class for whom the protection of § 14(e) was designed, and therefore had standing to sue. The court further implied that the class was in fact the investing public, since it was for the protection of same from misleading tender offers that § 14(e) was enacted.

[62] The court determined that CCI was entitled to damages in the amount of the reduction in value of CCI's Piper holdings attributable to BPC's taking a majority position in Piper. 480 F.2d at 380.

[63] *See generally* Iroquois Indus., Inc. v. Syracuse China Corp., 417 F.2d 963, 969 (2d Cir. 1969), *quoting* Church v. Hegstrom, 416 F.2d 449, 451 (2d Cir. 1969).

[64] 480 F.2d at 396.

Thus, while Judge Timbers preferred a rigorous analytical approach to the standing question, and Judge Mansfield felt a simple analogy would be sufficient, their conclusions are effectively identical. They both recognized that CCI, as a tender offeror, was within the class which section 14(e) was designed to protect, that the most effective way to further the general objective of section 14(e) was to grant standing to sue to victims of its violations, and that CCI was such a victim.

A review of the history of the standing problem as it relates to rule 10b-5 points up the very real breakthrough which this ruling effects.

Birnbaum v. Newport Steel Corp.[65] was the first major case decided under rule 10b-5 which effectively limited standing to purchasers and sellers. There, the Second Circuit enunciated its purchaser-seller limitation, which later enabled courts to summarily dismiss cases falling outside the purchaser-seller class.[66] Eventually, the rigidity of the *Birnbaum* doctrine gave way somewhat in *Vine v. Beneficial Finance Co.*,[67] wherein the court enunciated the forced-seller doctrine, which enabled it to grant standing to sue to the plaintiff. This decision, as well as that in *A. T. Brod & Co. v. Perlow*,[68] suggested a relaxation of the *Birnbaum* doctrine, and lower courts were quick to follow the lead.[69] However, in *Iroquois Industries, Inc. v. Syracuse China Corp.*[70] the court reasserted the *Birnbaum* doctrine and made its application clear in damage actions. [71] This, then, was the state of the law at the time the Williams Act was enacted, and it was not until *Chris-Craft* that the standing question was given the broad

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[65] 193 F.2d 461 (2d Cir.), *cert. denied,* 343 U.S. 956 (1952). The court interpreted the purchase or sale clause of rule 10b-5 to mean that a plaintiff must either be a purchaser or seller of securities.

[66] *See, e.g.,* Studebaker Corp. v. Allied Prods. Corp., 256 F.Supp. 173 (W.D. Mich. 1966).

[67] 374 F.2d 627 (2d Cir.), *cert. denied,* 389 U.S. 970 (1967). "It is precisely because appellee gives no choice to Vine under the statute and the latter must now exchange his shares for cash that appellant can now be deemed a seller . . . ." Vine v. Beneficial Finance Co., *supra* at 635.

[68] 375 F.2d 393 (2d Cir. 1967). *Brod* was initially dismissed by the district court, because plaintiff had not alleged that he was an investor or that fraud was associated with the purchase or sale of securities. The Second Circuit reversed, holding that 10b-5 was enacted for the benefit of the public and was not limited solely to investors. A. T. Brod & Co. v. Perlow, *supra* at 397.

[69] *See* Entel v. Allen, 270 F.Supp. 60, 69 (S.D.N.Y. 1967); Moore v. Great-america Corp., 274 F.Supp. (N.D. Ohio 1967), *See also* Symington Wayne Corp. v. Dresser Indus., Inc., 383 F.2d 840 (2d Cir. 1967); Mutual Shares Corp. v. Genesco, Inc., 384 F.2d 540 (2d Cir. 1967); Pacific Insurance Co. v. Blot, 267 F.Supp. 956 (S.D.N.Y. 1967).

[70] 417 F.2d 963 (2d Cir. 1969), *cert. denied,* 399 U.S. 909 (1970)

[71] *Contra,* Crane Co. v. Westinghouse Air Brake Co., 419 F.2d 787 (2d Cir. 1969). *See* note 54 *supra.*

extension required to enable parties involved in the tender offer transaction to challenge effectively in the courts without having to fear summary dismissal based on the purchaser-seller limitation.

The court has thus furthered a trend, which has been developing since the 1968 amendments, toward liberalizing standing to sue under section 14(e).[72] Though limited in this case to standing for a defeated tender offeror, the private action-enforcement rationale lends itself to situations wherein shareholders of either side seek relief for misleading or deceptive conduct in connection with a tender offer.

Violations of Section 14(e)

Judge Timbers began his discussion of the defendants' alleged violations of section 14(e) with an elucidation of the controlling principles in the determination of such liability. He first observed that he deemed the underlying proscription of section 14(e) to be identical to that of rule 10b-5, the critical difference being the latter's application only "in connection with the purchase or sale of any security" as opposed to the former's application "in connection with any tender offer."[73] For this reason, he chose to follow the principles developed under rule 10b-5 regarding the elements of section 14(e) violations.

Thus, a violation of section 14(e) is shown when:

> . . . there has been a material misstatement or omission concerned with a tender offer and when such misstatement or omission was sufficiently culpable to justify granting relief to the injured party.[74]

Materiality

Judge Timbers found the standard of materiality for violations of section 14(e) to be identical to that articulated in a number of cases decided under rule 10b-5: "whether a reasonable man would attach importance to the fact misrepresented in determining his choice of action in the transaction in question."[75] The analogy of violations of section 14(e) to those of rule 10b-5 is, in itself, an expansion on the former comparison to violations of section 14(a) on proxy regulations.[76] With the introduction of the less stringent standard of materiality, however, Judge Timbers has greatly enlarged the scope of materiality in a 14(e) action.

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[72] *See generally* Note, *Tender Offers: The Liberalization of Standing, supra* note 12.

[73] 480 F.2d at 362.

[74] *Id.*

[75] *Id.* at 363, *quoting* List v. Fashion Park, Inc., 340 F.2d 457, 462 (2d Cir.), *cert. denied,* 382 U.S. 811 (1965).

[76] 15 U.S.C. § 78n(a) (1970).

In *Electronic Specialty,* the only previous case construing this issue as it applies to section 14(e), a much narrower standard of materiality was fashioned. Judge Friendly, writing for the Second Circuit, saw fit to embrace the test underlying court decisions dealing with proxy contests, seemingly on the rationale that tender offers can be much likened to proxy contests in their fundamental features.[77] The rationale appears incongruous when compared to a statement in the same opinion:

> In effect section 14(e) applies rule 10-b both to the offeror and to the opposition — very likely, except perhaps for any bearing it may have on the issue of standing, only a codification of existing case law.[78]

If indeed section 14(e) only affects the scope of standing to sue under rule 10b-5, then it follows that the basic test of materiality set forth in *List v. Fashion Park, Inc.,*[79] and reaffirmed in *S.E.C. v. Texas Gulf Sulphur Co.,*[80] should be applicable. In *List* the court said:

> The basic test of "materiality" . . . is whether "a reasonable man would attach importance [to the fact misrepresented] in determining his choice of action in the transaction in question."
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> * * *
>
> "Materiality" encompasses those facts "which in reasonable and objective contemplation might affect the value of the corporation's stock or securities . . . ."[81]

The basic difference between this test (which is similar to the *Chris-Craft* test) and the one promulgated by Judge Friendly in *Electronic Specialty* is that the latter looks to a determination of whether knowledge of the true facts *would* have compelled a different result, whereas the former impliedly depends upon whether it *might* have done so.[82]

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[77] Electronic Specialty Co. v. International Controls Corp., 409 F.2d 937, 948 (2d Cir. 1969). The court reaffirmed the test announced in Symington Wayne Corp. v. Dresser Indus., Inc., 383 F.2d 840, 843 (2d Cir. 1967) to wit:

> . . . whether "any of the stockholders who tendered their shares would probably not have tendered their shares" if the alleged violations had not occurred.

[78] Electronic Specialty Co. v. International Controls Corp., 409 F.2d 937, 940-41 (2d Cir. 1969).

[79] 340 F.2d 457 (2d Cir.), *cert. denied,* 382 U.S. 811 (1965).

[80] 401 F.2d 833 (2d Cir. 1968), *cert. denied,* 394 U.S. 976 (1969).

[81] List v. Fashion Park, Inc., 340 F.2d 457,462 (2d Cir.), *cert. denied,* 382 U.S. 811 (1965); *quoting in part* RESTATEMENT OF TORTS § 538(2)(a) (1938), *and quoting in part* Kohler v. Kohler Co., 319 F.2d 634, 642 (7th Cir. 1963).

[82] *See* Binder, *The Securities Law of Contested Tender Offers,* 18 N.Y.L.F. 569, 632 n. 368 (1973).

In addition, the court in *Electronic Specialty* confused the test of materiality with that of reliance. It is much easier for a plaintiff to show that a particular omission might have affected the decision of a reasonable investor than it is to show that it did affect the plaintiff's decision. The elements of materiality and reliance are separate and distinct.[83] The test to be considered when determining materiality is based on a reasonable man's evaluation of the weight given to a representation in deciding on his choice of action.[84] In sharp contrast, the test to be considered when determining reliance is based on the reasonable man's evaluation of the credibility and accuracy of defendant's representation.[85] Thus, to confuse the two needlessly intermingles two distinct areas and results in an overly difficult burden of proof for the plaintiff. This burden is especially difficult in a tender offer suit brought by either the target or the offeror wherein they must show reliance by third party shareholders.

Finally, in light of human experience, which suggests that the subjective decision-making process is subject to random inputs, none of which can be quantified over a range of individual investors, it seems appropriate to make use of a materiality test which does not seek to quantify these variables.[86] The *Electronic Specialty* test fails in this regard, whereas the test put forth by Judge Timbers seemingly does not. Thus, Judge Timbers' expansion of the standard of materiality is an eminently desirable and realistic broadening of its scope under section 14(e).

Scienter

In observing that a showing of culpability is requisite for proof of scienter, Judge Timbers incorporated his concept of culpability into the large body of law which has developed regarding the scienter requirement of rule 10b-5. He defined culpability as knowing or reckless failure to ascertain and disclose those facts concerning which there is a "duty of disclosure."[87] Judge Mansfield, however, felt that Judge Timbers' reasoning on the issue of culpability had the effect of compounding already existing confusion as to the law in the area.[88] He further observed that Judge Timbers had provided "uncertain and

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[83] *See* Myzel v. Fields, 386 F.2d 718, 733 (8th Cir. 1967), *cert. denied,* 390 U.S. 951 (1968); wherein the court announced the elements necessary in a private action for damages from misrepresentation or nondisclosure, to wit: 1. a misrepresentation or nondisclosure, 2. materiality, 3. some form of scienter or intent, and 4. reliance.

[84] *See* Note, *The Nature and Scope of the Reliance Requirement in Private Actions Under SEC Rule 10b-5,* 24 CASE W. RES. L. REV. 363, 386-87 (1973).

[85] *Id.*

[86] *See* S.E.C. v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 200-201 (1963). "The motives of man are too complex to separate."

[87] 480 F.2d at 363.

[88] *Id.* at 398.

apparently conflicting guidelines" concerning the nature and extent of the duty to disclose.[89] On the one hand, Judge Timbers observed that the duty is one which requires reasonable action on the part of a corporate officer in discovering and disclosing facts material to the exchange offer.[90] But on the other hand, that statement was promptly limited by the observation that "corporate officers have a reasonable area of discretion in determining how far to explore the facts and in deciding what facts need to be disclosed. So long as they operate within this area, the securities laws do not impose liability."[91]

Judge Mansfield felt that:

> . . . the scienter requirement would be met if the corporate officer (1) knew the essential facts and failed to disclose them, or (2) failed or refused, after being put on notice of a possible material failure in disclosure, to apprise himself of the facts under circumstances where he could reasonably have ascertained and disclosed them without any extraordinary effort.[92]

This standard of responsibility, he felt, was "in keeping with the broad remedial aims of the anti-fraud provisions of the federal securities laws."[93] In conclusion, he observed that a corporate officer with knowledge of material facts, according to the laws' standards, "cannot in his discretion decide not to disclose them without facing liability under section 14(e)."[94]

Several questions are raised by the different positions taken by the two judges. An analysis of cases decided on the basis of rule 10b-5 by the Second Circuit, as well as several other circuits, points up the unsettled state of the law with regard to the scienter requirement.

The basic problem revolving around the requirement of scienter is whether the plaintiff may recover simply by showing that a misleading statement had been made, or whether he must prove some degree of fault on the defendant's part. Three basic alternatives have been suggested. They are: 1. absolute liability, *i.e.*, the fact that the statements made were false or misleading is sufficient to establish liability; 2. intentional liability, *i.e.*, the false or misleading statement must have been made knowingly or with an intent to mislead; 3. negligence liability, *i.e.*, the defendant will be liable, even without knowledge of the deception, if in the exercise of reasonable care he should have had knowledge of it.[95]

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[89] *Id.*

[90] *Id.* at 369.

[91] *Id.*

[92] *Id.* at 398.

[93] *Id.*

[94] *Id.* at 399.

[95] Note, *Negligent Misrepresentations Under Rule 10b-5,* 32 U. CHI. L. REV. 824, 827 (1965).

The first alternative, absolute liability, has been largely ignored in recent cases, probably because of the effect such an approach would have on the general field of securities transactions.[96] However, to a large extent, as will be shown, the concept of absolute liability is little more than a reflection of the holdings of the courts with regard to the imputation of liability for knowingly failing to disclose material information. Nevertheless, the problem that has plagued the courts has been that of distinguishing between the second and the third alternatives.

The Second Circuit more than any other has examined the scienter requirement, and largely as a result of differences in the language chosen by the various judges in the circuit, much uncertainty still remains regarding the status and nature of scienter.[97]

In *S.E.C. v. Texas Gulf Sulphur Co.*,[98] Judge Waterman, in the principal opinion of the case, observed in his discussion of the law applicable to insider trading without disclosure of material facts that "the common law standard of deceptive conduct has been modified in the interests of broader protection for the investing public so that negligent insider trading has become unlawful . . . ."[99] He further insisted that a "similar standard has been adopted in private

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[96] At least one case seemed to show a willingness to allow a plaintiff to sue under rule 10b-5 without pleading and proving scienter. *See* Texas Continental Life Ins. Co. v. Bankers Bond Co., 187 F.Supp. 14, 23 (W.D. Ky. 1960), *rev'd on other grounds sub nom.*, Texas Continental Life Ins. Co. v. Dunne, 307 F.2d 242 (6th Cir. 1962) ("a plaintiff purchaser need only prove that a statement in a prospectus or oral communication is in fact false or is a misleading omission."); *cf* Dack v. Shanman, 227 F.Supp. 26, 29 (S.D.N.Y. 1964) ("It is sufficient to allege that defendants made untrue statements of material facts or omitted to state material facts"). *See also* Ellis v. Carter, 291 F.2d 270 (9th Cir. 1961). But several treatments of the subject have suggested that such an approach would retard the goals of securities regulations. *See* Note, *Proof of Scienter Necessary in a Private Suit Under SEC Anti-fraud Rule 10b-5*, 63 MICH. L. REV. 1070, 1077-78 (1965); Note, *Negligent Misrepresentation Under Rule 10b-5*, 32 U. CHI. L. REV. 824, 834-35 (1965).

[97] At least four positions on the scienter requirement can be discerned from the language of the various judges in the Second Circuit. Judge Hays in *Texas Gulf Sulphur* would have granted the injuction sought by the SEC and would not have remanded the case on the issue of due diligence of the corporation, 401 F.2d 833, 869-70. Judge Waterman in *Texas Gulf Sulphur* appeared willing to impute liability for negligence in private actions, 401 F.2d 833, 854-55. Judge Friendly would limit liability to situations in which actual knowledge or reckless disregard for the truth is found, 401 F.2d at 867-68. And Judge Moore dissented in *Texas Gulf Sulphur.*

[98] 401 F.2d 833 (2d Cir. 1968) (en banc), *cert. denied*, 394 U.S. 976 (1969). A brief outline of the facts is as follows. On November 12, 1963, a TGS exploration group completed drilling in an area considered to contain extensive mineral deposits. The evaluation of the information from this drill hole was considered to be material information by the Second Circuit, but prior to public disclosure, several insiders purchased TGS stock. On April 16, 1964, TGS held a press conference to announce a substantial ore strike. Four days prior to the conference, however, the company had attempted to clarify rumors concerning the strike via a public statement. The SEC alleged that this statement (April 12 press release) was misleading and deceptive. The SEC brought suit under rule 10b-5 against both TGS insiders and TGS itself.

[99] SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 854-55 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969).

actions. . . ."[100] However, as Judge Friendly noted, the facts of the case did not require such a holding, for it was clearly shown that the defendants *had* full knowledge of the undisclosed material facts therein.[101]

Additional confusion was introduced through Judge Waterman's statement concerning the April 12 press release when he noted:

> It seems clear, however, that if corporate management demonstrates that it was diligent in ascertaining that the information it published was the whole truth and that such diligently obtained information was disseminated in good faith, Rule 10b-5 would not have been violated.[102]

The "due diligence" defense suggested by Judge Waterman clearly implies a negligence standard. However, Judge Friendly felt that the April 12 press release provided "the worst possible case for the award of damages for merely negligent misstatement, as distinguished from the kind of recklessness that is equivalent to willful fraud."[103] The fact that two judges specifically concurred with this aspect of Judge Friendly's opinion,[104] and that two more dissented entirely from the imposition of liability on the corporation for the misleading press releases,[105] suggests that a majority of the court was not prepared to allow the imposition of damages for merely negligent misrepresentations.[106]

In *Heit v. Weitzen,*[107] decided the same year as *Texas Gulf Sulphur,* the court discussed the opinions of both Judges Waterman and Friendly and noted that, due to the fact that the complaints in issue

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[100] *Id.* at 855. Judge Waterman, when making this statement, cited solely other circuits' decisions as support. *Id.* at 855. This raises the question of whether he really meant to apply a negligence standard in the second circuit. Although it is clear that Judge Waterman did not base his decision on negligent conduct on the part of defendants, he did reinforce his dicta with a discussion of legislative intent and particularly with the following comment:

> Moreover, a review of other sections of the Act from which Rule 10b-5 seems to have been drawn suggests that the implementation of a standard of conduct that encompasses negligence as well as active fraud comports with the administrative and the legislative purposes underlying the Rule.

Id. at 855.

[101] *Id.* at 868 n. 4. Defendants' knowledge of the drill results was not in dispute. *Id.* at 852-53.

[102] *Id.* at 862. Judge Waterman felt that it would not be unfair to "impose upon corporate management a duty to ascertain the truth of any statements" that a corporation releases, whether to the shareholders or the investing public at large. *Id.* at 861.

[103] *Id.* at 868. Judge Friendly's basic disagreement with Judge Waterman appeared to be his view of the conduct in question. Whereas Judge Waterman's dicta referred to negligence and a "due diligence" defense, Judge Friendly felt that there was no question of due diligence since the defendants were fully aware of the fact that the public was ignorant of certain material facts. Rather, he saw the issue as one of recklessness on the part of defendants. *Id.* at 868 n. 4.

[104] Judges Kaufman and Anderson, *id.* at 869.

[105] Judges Moore and Lumbard, *id.* at 870.

[106] *See* Bucklo, *Scienter and Rule 10b-5,* 67 NW. U. L. REV. 562, 579 (1972).

[107] 402 F.2d 909 (2d Cir. 1968).

alleged actual knowledge as well as negligence, they were adequate "whether the *scienter* test ultimately applied be strict or liberal."[108] Despite ambigious statements in several cases to the effect that the requirement of scienter should be eased, relaxation has not yet appeared to be necessary. In all the Second Circuit cases discussing the scienter issue, actual knowledge has either been found or alleged.[109]

At least two other circuits have expressly or impliedly stated that mere negligence is sufficient for 10b-5 liability in a private suit against the maker of a misleading statement. The Eighth Circuit, in *City National Bank v. Vanderboom,*[110] stated that it disagreed with the Second Circuit insofar as that court did not accept a negligence test. And the Tenth Circuit, in *Mitchell v. Texas Gulf Sulphur Co.,*[111] stated that a defendant could avoid liability if he sustains the burden of proving that he did not know, and in the exercise of reasonable care would not have known, of the misrepresentations or omissions. The statements of both courts, however, were unnecessary inasmuch as the *Vanderboom* case was dismissed on the issue of standing and the *Mitchell* case involved knowing misrepresentations.[112]

Thus, it seems that despite the different standards the various circuits have been willing to apply to the scienter requirement, the defendants in private actions have consistently either had actual knowledge of the falsity of their misrepresentations or have acted with reckless disregard of the truth. And although statements in a number of cases which have discussed the scienter requirement can be interpreted as approving a relaxation of standards, in none of these cases has a private plaintiff recovered damages for merely negligent conduct.[113]

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[108] *Id.* at 914.

[109] *See* Shemtob v. Shearson, Hammill & Co., 448 F.2d 442 (2d Cir. 1971) (court dismissed suit for lack of allegations of facts amounting to scienter while stating the allegation of mere negligence is insufficient), Globus v. Law Research Service, Inc., 418 F.2d 1276 (2d Cir. 1969), *cert. denied,* 397 U.S. 913 (1970) (court noted that trend is away from scienter requirement equal to fraud, but defendants had actual knowledge); SEC v. Great American Indus., Inc., 407 F.2d 453 (2d Cir. 1968) (en banc), *cert. denied,* 395 U.S. 920 (1969) (court held defendants' actions constituted common law fraud). *See also* Bucklo, *supra* note 106, at 576-81.

[110] 422 F.2d 221, 229-30 (8th Cir. 1970), *See also* Ellis v. Carter, 291 F.2d 270 (9th Cir. 1961) (the Ninth Circuit stressed the fact that § 10(b) speaks in terms of "*any* manipulative device or contrivance," implying a negligence standard).

[111] 446 F.2d 90, 102 (10th Cir. 1971).

[112] City National Bank v. Vanderboom, 422 F.2d 221, 232 (8th Cir. 1970); Mitchell v. Texas Gulf Sulphur Co., 446 F.2d 90, 96 (10th Cir. 1971).

[113] *See, e.g.,* Gilbert v. Nixon, 429 F.2d 348 (10th Cir. 1970) (court used negligence standard, but misrepresentations involved were knowing or reckless); Stevens v. Vowell, 343 F.2d 374 (10th Cir. 1965) (court said finding of negligence would suffice, but misrepresentations were sufficient to find fraud); Royal Air Properties v. Smith, 312 F.2d 210 (9th Cir. 1962) (court stated that a prima facie case will be made when proof of material misstatement or omission is shown, but defendant had actual knowledge).

The question then becomes, where the standards elucidated by Judge Timbers and Judge Mansfield fit on the continuum of various catchphrases announced by the courts. This is best answered by an analysis of what each of the judges said in enunciating his scienter-culpability standards.

Judge Timbers felt that the function of the scienter requirement is to confine liability "to those whose conduct has been sufficiently culpable to justify the penalty sought to be exacted."[114] In making a determination of culpability, it is first necessary to discern what duty of disclosure is imposed on the defendant. Thus, Judge Timbers observed:

> [w]hen making a representation, [those with greater access to information] are required to ascertain what is material as of the time of the transaction and to disclose fully "those material facts about which the [investor] is presumably uninformed and which would, in reasonable anticipation, affect his judgments.[115]

He noted that a failure to perform these duties with due diligence in issuing registration materials would be sufficient for liability under section 11 of the 1933 Act,[116] but to justify a judgment under rule 10b-5 or section 14(e), sufficiently culpable conduct amounting to a knowing or reckless failure to discharge these obligations must be shown.[117]

Thus Judge Timbers has apparently refused to accept the negligence standard which has surfaced in a number of 10b-5 cases. Rather, at the very least, he has accepted as applicable to section 14(e) the traditional view of scienter which has been used, notwithstanding the various language employed by the circuit courts in their treatment of 10b-5 cases. But a further analysis leads to the conclusion that Judge Timbers has made an important distinction in the scienter requirement under section 14(e); a distinction made more important by its probable application to rule 10b-5 cases. Judge Timbers went beyond the dichotomy made by all the courts between a knowing omission of a material fact and an omission of a material fact due to a reckless failure to ascertain that fact, and distinguished between a knowing omission which was reasonable and one which was unreasonable. For the first time a court has recognized the possibility that "culpability" sufficient to justify the imputation of liability may not be present despite the fact that defendant had knowledge of material informa-

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[114] 480 F.2d at 363.

[115] *Id.*

[116] 15 U.S.C. § 77k (1970).

[117] 480 F.2d at 363.

tion which was omitted. In the past, courts have uniformly held that a failure to disclose material information, which was known to the defendant, where there was a duty to disclose, was clearly sufficient for the imputation of liability.[118] This surpasses mere negligence and is tantamount to the imposition of absolute liability, subject to only two requirements: "knowledge" and a "material" omission. Judge Timbers, on the other hand, has seen fit to recognize the disparity between a decision on the materiality of a particular piece of information made by a corporate executive and that made by a judge sitting in the quiet of his chambers. While shrouding his language in the ambiguity of the term "culpability", Judge Timbers has, in fact, held that where a corporate officer's determination (that information was not material) is reasonable in light of the surrounding circumstances, liability will not be imputed for failing to disclose that information. This is to be contrasted with the previous rulings on the issue which skirted the problem and thus impliedly held that the reasonableness of the decision was irrelevant.[119]

Judge Mansfield, on the other hand, in his concurring and dissenting opinion, initially appears to be proferring the traditional scienter standard. His statement that the use of the words "fraudulent," "deceptive," and "manipulative" in section 14(e) by Congress, coupled with the similar language of section 10(b), indicates a congressional purpose "not to punish mere negligence,"[120] is compatible with both the traditional view of the Second Circuit in rule 10b-5 cases and Judge Timbers' statements in *Chris-Craft*. However, his observation on the proof requisite for a satisfaction of the scienter requirement is at odds with both of these views.[121] In point of fact, despite Judge Mansfield's repeated assertions that proof of more than mere negligence is necessary to satisfy the scienter requirement, his definition of that requirement would be satisfied by mere negligence in failing to ascertain a material fact. Thus it is the definition of the

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[118] *See* Bucklo, *supra* note 106, at 575.

[119] *See, e.g.,* Mitchell v. Texas Gulf Sulphur Co., 446 F.2d 90, 101 (10th Cir. 1971) (court stated that defendant could avoid liability if he sustained burden of proving that he did not know, and in the exercise of reasonable care would not have known, of the challenged misrepresentations or omissions); Globus v. Law Research Service, Inc., 418 F.2d 1276, 1291 (2d Cir. 1969), *cert. denied,* 397 U.S. 913 (1970) (court stated that there was an accusation of actual knowledge of material misrepresentations and omissions sufficient to satisfy the scienter requirement).

[120] 480 F.2d at 397.

[121] Judge Timbers stated:

> The *scienter* requirement would be satisfied upon a showing that the person charged knew the material facts misstated or omitted and could reasonably have been expected to appreciate their significance, . . . or, if he did not know them, that he had reasonable cause to believe that there might be a material failure in disclosure and yet did not ascertain and disclose the facts even though he could have done so without any undue effort.

Id. at 398. This gives every appearance of being a negligence standard.

scienter requirement, as well as the term "culpability" used by Judge Timbers, that differentiates the two opinions in the case. While Judge Timbers has chosen to forge a new tool for restricting the imputation of liability, Judge Mansfield has surfaced as part of a distinct minority which has been attempting to relax the scienter requirements.

Two questions still remain. Which view, if either, would appear to be the better one? And, would it make a difference in this case?

An analysis of the views of the two judges must, of necessity, involve a comparison between two dissimilar issues. Judge Timbers put forth a limiting measure on the imputation of liability for knowing omission of a material fact. Judge Mansfield, however, attempted to extend liability to conduct amounting to negligence in failing to ascertain a material fact. The distinction is sufficient to require separate treatment.

Judge Timbers, in imposing a restriction on the imputation of liability for knowing omissions, has conformed his reasoning to the reality of the situation. It seems patently inequitable to suggest that liability should rest solely on the basis of whether the decision of a judge, with the benefit of hindsight, concerning the materiality of non-disclosed information agrees with the decision of a corporate executive with all the attendant pressures. As noted by Judge Timbers, it is important to take cognizance of Judge Friendly's statement in *Electronic Specialty:*

> The likeness of tender offers to proxy contests is not limited to the issue of standing. They are alike in the fundamental feature that they generally are contests. This means that participants on both sides act, not in the peace of a quiet chamber [Citations Omitted]; but under the stresses of the market place. They act quickly, sometimes impulsively, often in angry response to what they consider, whether rightly or wrongly, to be low blows by the other side. Probably there will no more be a perfect tender offer than a perfect trial. Congress intended to assure basic honesty and fair dealing, not to impose an unrealistic requirement of laboratory conditions. . . .[122]

It would appear that Judge Timbers has removed some of the laboratory-like conditions in the consideration of knowing omissions and has substituted, via a reasonableness standard, the exigencies of the market place.

Judge Mansfield, on the other hand, felt that a corporate executive with knowledge of material facts could not escape liability for failing to disclose these facts. The fatal flaw in this reasoning is his

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[122] *Id.* at 362 n. 14.

unwillingness to permit the defendant a standard of reasonableness in determining what is material. The liabilities under either rule 10b-5 or section 14(e) are too great to employ an absolute liability standard which would impute liability for even a reasonable mistake in judgment. For this reason, it seems that the standard proposed by Judge Timbers is the better one with regard to *knowing* omissions.

In comparing the scienter requirement of rule 10b-5 to that of section 14(e) for failing to *discover* material information, it is necessary to take cognizance of several factors. First, the fact that rule 10b-5 is such a broad provision and covers a variety of circumstances somewhat justifies a refusal to impute liability for mere negligence. Such is not true of section 14(e). Section 14(e) applies only "in connection with any tender offer," and, though the area included by the definition of tender offers is large, it does not approach that of rule 10b-5. Second, rule 10b-5 was formulated under a statutory provision which permits the SEC to promulgate regulations to prevent the use of any "manipulative or deceptive device or contrivance."[123] For this reason, it has been argued that these very words imply a degree of intent. Thus some form of scienter must be proven or the rule would be outside the scope of the Commission's authority.[124] Again, this limitation does not hold true for section 14(e). Since section 14(e) is self-enforcing, it has no need for implementing rules. Furthermore, the section can effectively be separated into two subsections, permitting liability to be based on a violation of the section without considering the limiting words — "fraudulent, deceptive, or manipulative acts or practices . . . ."[125]

Third, and probably most important, one of the major problems with the private-enforcement concept of securities regulations has been the disproportionate amount of damages for which an insider may be liable. Thus, it has been suggested that the issue of damages and the state of the defendant's mind must be considered together.[126] Undoubtedly, courts, when considering 10b-5 cases, pay careful attention to the potential liability when delineating the requirement of scienter. This need not be the case under section 14(e). The wide variety of relief available to the courts, together with the totally different nature of the damages, should cause the courts markedly less anxiety over the potential liability for violations of section 14(e).[127]

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[123] 1934 Act § 10(b), 15 U.S.C. § 78j(b) (1970).

[124] *See* Trussell v. United Underwriters, Ltd., 228 F.Supp. 757, 772 (D. Colo. 1964).

[125] 1934 Act § 14(e), 15 U.S.C. § 78n(e) (1970). See text accompanying note 32 *supra.*

[126] *See* Ruder, Texas Gulf Sulphur — *The Second Round: Privity and State of Mind in Rule 10b-5 Purchase and Sale Cases,* 63 NW. U. L. REV. 423, 427 (1968).

[127] In rule 10b-5 actions, the selling shareholder would receive as damages the difference between the market price at the time of sale and the market price at a later date. *See*

(Continued on next page)

Thus, it would seem that many of the restrictions under rule 10b-5, which arguably would prevent the use of a scienter requirement that includes mere negligence for failing to ascertain material facts, do not apply to section 14(e). However, this does not answer the question of which standard would be better, but only suggests that there are fewer arguments against Judge Mansfield's view under section 14(e) than there would be under rule 10b-5. The question, then, is which standard furthers the goals of the securities legislation more effectively. The answer appears to be that standard which minimizes investor injury as a result of corporate misrepresentation, maximizes the flow of information to that same investor, and results in the protection of potential defendants from liability in the absence of substandard conduct. Since in the case of a tender offer the flow of information to the shareholders is statutorily mandated,[128] it would appear that the flow of information to the shareholder-investor cannot be affected. At the same time, the employment of a negligence standard prevents the imposition of absolute liability as has been the case with knowing omissions. For these reasons, the minimization of investor injury and the most effective method of furthering the goals of the securities legislation can best be accomplished by the employment of a scienter requirement which includes mere negligence in failing to ascertain material facts — Judge Mansfield's standard.

To answer the final question — whether there would be any difference in the result in the case under either of the two standards — resort must be had to the findings of the court in regard to the liability of defendants for the specific allegations of violations of section 14(e).

Judge Timbers found that the Piper family had violated section 14(e) in their letters to shareholders on January 27 and 28, in their press release of January 29, and in their letters to shareholders on June 4 and July 25. He felt that the reference to "inadequate" in the letters of January 27 and 28 pertained to price, and therefore had a material bearing on a reasonable investor's decision.[129] This, coupled with the fact that First Boston had given Piper its opinion that the price was "fair and equitable," was sufficient, he felt, to show a knowing misrepresentation. He similarly found the omission of the "put"

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Janigan v. Taylor, 344 F.2d 781, 786 (1st Cir.), *cert. denied,* 382 U.S. 879 (1965); Baumel v. Rosen, 283 F.Supp. 128, 147 (D. Md. 1968). However, the *Chris-Craft* court felt that the measure of damages to CCI would be the reduction in appraisal value of CCI's Piper holdings due to BPC's having acquired a majority interest in Piper. The nature of the damages should cause much less concern over the possibility of dramatic sums being awarded.

[128] This is a result of the combined effect of § 14(d), 15 U.S.C. §78(n)(d) (1970) and §14(e), 15 U.S.C. § 78(n)(e) (1970). See text accompanying notes 26 and 27 *supra.*

[129] 480 F.2d at 364.

arrangement with Grumman from the January 29 press release as well as the omission of the agreement between Piper and BPC in the June 4 and July 25 letters to be violations of section 14(e).[130]

Judge Timbers further held that BPC and its officers and First Boston and its officers had violated section 14(e) by failing to include material information in BPC's registration statement. He found that BPC was required to disclose to Piper shareholders the circumstances surrounding the negotiation for the sale of the BAR, and to inform them of the effects this might have on the operations of BPC.[131] In all of these holdings he found that the "culpability" of the defendants was sufficient to justify liability. Consequently, it would appear that under either Judge Timbers' or Judge Mansfield's standard for knowing ommissions, the results would be similar.

In addition, Judge Timbers found that First Boston's failure to investigate BPC's intentions with regard to the BAR after being put on notice of discussions with regard to its disposal amounted to "complete abdication of its responsibilities to potential investors."[132]

To arrive at the latter holding, Judge Timbers first had to negotiate the question of whether section 14(e) imposes liability upon an underwriter in favor of a competing offeror. In determining that it did, he cited self-regulation as the mainspring of the federal securities laws, and he observed that, due to the relationship between the underwriter and the registrant, "[t]he representations in the registration statement are those of the underwriter as much as they are those of the issuer."[133]

Judge Timbers felt it unnecessary to determine whether a reasonableness standard should be imposed under section 14(e) since "First Boston's conduct . . . went far beyond mere negligence."[134] This view is questionable. In discussing First Boston's culpability, Judge Timbers observed that even if the minutes of the May 21 board meeting were not sufficient in themselves to lead a "reasonable" person to believe that the registration statement was misleading, a "reasonable" person would have explored further.[135] He then concluded that "First Boston possessed enough information reasonably to deduce that the BPC registration statement was materially inaccurate."[136] Despite his protestation, Judge Timbers' language and holding sounds suspiciously

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[130] *Id.*

[131] *Id.* at 368.

[132] *Id.* at 373.

[133] *Id.* at 370.

[134] *Id.* at 373 n. 26.

[135] *Id.* at 372.

[136] *Id.* at 373.

like a "reasonable man" standard — due digilence in discovering material information. Thus, although it appears there would be no difference in the court's holdings under either Judge Timbers' or Judge Mansfield's standards for the scienter requirement, there is a strong suggestion that, in applying his standard, Judge Timbers was in reality using an identical test to the one Judge Mansfield has promulgated.[137]

To summarize, it would appear that, despite denials by both judges, they have indeed imputed liability under section 14(e) for mere negligence.

Causation

Judge Timbers next discussed the issue of causation. He first observed the CCI need not show it relied on the defendant's deception, but rather that the target corporation's stockholders relied on a misrepresentation that caused CCI's injury.[138] He then cited the Supreme Court in its opinions in *Mills v. Electic Auto-Lite Co.*[139] and *Affiliated Ute Citizens v. United States*[140] as support for the proposition that a presumption of reliance will be established where it is logical to assume that reliance existed, thus avoiding the impracticality of proving actual reliance. Judge Timbers noted that effectuating Congressional intent is best accomplished by resolving doubts in favor of those the statute is designed to protect.[141]

Judge Mansfield, in his concurring and dissenting opinion, felt that Judge Timbers' application of the *Mills-Ute* test via a presumption of reliance where material misrepresentations are shown did not go far enough. He noted that the Supreme Court in *Mills* and *Affiliated Ute* did not use the term presumption, nor did they indicate in any manner that the concept of presumption was applicable.[142] He felt that the Supreme Court did not stop short at merely shifting the burden of proof to the defendant, but rather established a rule of law: reasonable reliance is found as a matter of law when a material misrepresentation is shown.[143]

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[137] In *Lanza v. Drexel & Co.*, 479 F.2d 1277 (2d Cir. 1973), Judge Timbers, in a concurring and dissenting opinion, concurs with the dissent of Judge Hays, who would have held an outside director liable for negligently failing to discover material omissions in representations made to a prospective purchaser of the corporation's stock. Although Judge Timbers felt that the conduct in question went beyond mere negligence to reckless disregard for the truth, much as he stated in the *Chris-Craft* opinion concerning First Boston, he went on to state that he did not necessarily disagree with Judge Hays' views on the scienter-negligence issue, but would prefer to wait until the issue was clearly presented to the court.

[138] 480 F.2d at 341.

[139] *Id.* at 374, *citing* 396 U.S. 375 (1970).

[140] *Id., citing* 406 U.S. 128 (1972).

[141] *Id.* at 375.

[142] *Id.* at 400.

[143] *Id.*

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The issue of reliance, like that of scienter, is presently in a state of confusion. Three classes of cases have been delineated. Each must be referred to in order to determine the standard of reliance that must be met: 1. cases wherein defendant knowingly makes affirmative misrepresentations; 2. cases wherein defendant makes negligent misrepresentations; and 3. cases wherein defendant omits material information.[144]

The two categories that the *Chris-Craft* court was concerned with are those involving misrepresentations known to be false, and those involving omissions. These two categories differ in one basic respect — "reliance on the nondisclosure of a fact is a particularly difficult matter to define or prove."[145] Reliance requires an acceptance of the credibility of the fact represented. Where there is no fact represented,[146] it is virtually impossible to prove reliance.[147] For this reason the two normally are treated separately. The Supreme Court in *Mills* and *Affiliated Ute* dealt with reliance and causation as they apply to material omissions. In *Mills,* Justice Harlan, writing for the majority, after defining materiality in several ways including the definition used by the *Chris-Craft* court, observed that this definition "embodies a conclusion that the defect was of such a character that it was considered important by a reasonable shareholder....[148] Thus he concluded that a finding of materiality is sufficient to show the causal relationship between the violation and the injury.[149]

In *Affiliated Ute,* the Court went one step further. Finding that positive proof of reliance is not a prerequisite to recovery,[150] the Court held that the "obligation to disclose and [the] withholding of a material fact establish the requisite element of causation in fact."[151]

Thus, it would seem that the presumption that Judge Timbers referred to is not a presumption at all, but rather a rule of law. However, it would appear that a better approach might be to consider

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[144] *See* Note, *The Reliance Requirement, supra* note 84, at 364.

[145] Mills v. Electric Auto-Lite Co., 396 U.S. 375, 382 n.5 (1970).

[146] *List v. Fashion Park, Inc.,* 340 F.2d 457, 463 (2d Cir.), *cert. denied,* 382 U.S. 811 (1965), stated that plaintiff need not prove active reliance on the defendant's silence, thereby rejecting concept that defendant was representing the converse of the omitted matter by maintaining silence.

[147] *See generally* Note, *The Reliance Requirement, supra* note 84, at 379-80.

[148] Mills v. Electric Auto-Lite Co., 396 U.S. 375, 384 (1970). The definition used by the *Chris-Craft* court was:

> whether 'a reasonable man would attach importance [to the fact misrepresented] in determining his choice of action in the transaction in question'

480 F.2d at 363.

[149] Mills v. Electric Auto-Lite Co., 396 U.S. 375, 385 (1970).

[150] Affiliated Ute Citizens v. United States, 406 U.S. 128, 153 (1972).

[151] *Id.* at 154.

omissions in two classifications: 1. intentional omissions, and 2. negligent omissions. In this way, a conclusive presumption of reliance might exist in the case of material omissions that were intentional or recklessly negligent, and a rebuttable presumption of reliance would result from material omissions that were caused by mere negligence. Judge Timbers did not state in his opinion whether the presumption of reliance which he found, was rebuttable or conclusive. Under the approach suggested, it would have been unnecessary since he felt that the material omissions in *Chris-Craft* were due to more than mere negligence. This rule also can be analogized to the standards for reliance in the case of material misrepresentations. A number of courts have held that the plaintiff need not prove that his reliance was reasonable, when the misrepresentations were known by the defendant to be false or misleading.[152] The fact that plaintiff actually relied is deemed to be sufficient. Although the courts have not articulated the underlying rationale for these holdings, the fact that to hold otherwise is tantamount to permitting contributory negligence as a defense to an intentional tort is most likely of primary importance. In sharp contrast, where the material misrepresentations were negligently caused, "reasonable" reliance has been the standard.[153]

Predictably, the rule would not alter the outcome of the holdings in *Chris-Craft.* Judge Timbers, despite language which implied that First Boston's liability with regard to the omissions in BPC's registration statement was a result of mere negligence, based his holdings on "a knowing or reckless failure to discharge..." the affirmative duty of disclosure.[154]

The court declined to treat the misrepresentations in the Piper family letters to shareholders on January 27 and 28, any differently from the rest of the violations of 14(e). That the *Mills* and *Affiliated Ute* Courts were considering failures to disclose (as opposed to positive misrepresentations) did not seem to matter.[155] It is difficult to criticize this approach. The burden of proof, where it is third party shareholders who must be shown to have relied, is very similar to that of

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[152] *See* Lehigh Valley Trust Co. v. Central National Bank of Jacksonville, 409 F.2d 989, 992 (5th Cir. 1969); John Hopkins University v. Hutton, 326 F.Supp. 250 (D. Md. 1971); Globus v. Law Research Service, Inc., 287 F.Supp. 188, 195 (S.D.N.Y. 1968), *aff'd as to compensatory damages, rev'd as to punitive damages,* 418 F.2d 1276 (2d Cir. 1969), *cert. denied,* 397 U.S. 913 (1970). *See generally* Note, *The Reliance Requirement, supra* note 84, at 370-73.

[153] See Mitchell v. Texas Gulf Sulphur Co., 446 F.2d 90, 103 (10th Cir.), *cert. denied,* 404 U.S. 1004 (1971); City National Bank v. Vanderboom, 422 F.2d 221, 230-31 (8th Cir.), *cert. denied,* 399 U.S. 905 (1970)

[154] 480 F.2d at 363.

[155] In *Mills,* liability was based on insufficient disclosure of the relationship of the Autolite board of directors, which endorsed a merger between Autolite and Mergenthaler Linotype Co. in a proxy statement to Mergenthaler. In *Affiliated Ute,* liability was based on defendants' failure to disclose the fact that they could gain financially from the transactions involved.

showing reliance on an omission (*i.e.*, next to impossible). For this reason, where there is little if any direction from the Supreme Court as to what would be the correct approach, a presumption of causation would seem to best effectuate the purpose of the securities laws. In this instance, however, since the nature of a misrepresentation is somewhat different from that of an omission and since there is a recognizable relationship between a misrepresentation and reliance thereon, it seems unnecessary to impose such a strict rule on defendants. Accordingly, the presumption should probably be rebuttable by showing, depending upon whether the misrepresentation was intentional or negligent, either unreasonable reliance or no reliance whatsoever.

Thus, although the court in *Chris-Craft* has not helped to clear the confusion which presently surrounds the issue of reliance, it does appear that its results were correct.

Judge Timbers then proceeded to the more straightforward issue of what results flowed from the various violations of section 14(e). He held the violations to have caused "a denial to CCI of a fair opportunity to compete for control of Piper."[156] The specific injury sustained was found to be a reduction in the value of CCI's Piper holdings. All of the aforementioned violations by various defendants were held to have contributed in some measure to this injury, with the exception of the June 4 and July 25 letters to Piper shareholders from the Piper family.[157] Despite the fact that these letters omitted material facts, their effect was rendered negligible by the action of CCI which had written letters of rebuttal on July 16 detailing the omitted facts.

Relief to be Granted

In determining the relief to be granted CCI, Judge Timbers appropriately considered two variants: damages and equitable relief. He first dismissed divestiture of BPC's illegally obtained shares as inappropriate due to administrative difficulties and the desire not to reopen the control contest.[158] Although this reasoning is not overly persuasive, courts may undoubtedly refuse to order divestiture for several reasons.[159] The *Chris-Craft* court might have picked any of them. First, forcing such a large block of shares onto the market would, in all probability, depress the price of the stock for some length of time. Innocent shareholders, and in this case the plaintiff, CCI, would suffer inordinate losses as a result. Second, divestiture by the successful contestant might, as it would in this case, leave the target company without effective management for a time, since (presumably) management of the target would have been taken over by the successful con-

[156] *Id.* at 375.

[157] *Id.* at 376-77.

[158] *Id.* at 379.

[159] *See* Note, *Cash Tender Offers, supra* note 11, at 401.

testant which, in all likelihood, would immediately withdraw its officers upon forced divestiture. Admittedly, it might be successfully argued that in a contested takeover the minority shareholders, losers in the contest, would readily assume the management of the target. In reality, however, the passage of time between the takeover contest and the outcome of a court fight would work to the disadvantage of the contest loser. In all likelihood substantial changes would have taken place in both the target company and the attitude of the loser toward it. This latter reason seems to be the true rationale behind Judge Timbers' statement on divestiture, as he was careful to point out that CCI "no longer desires to take control of a company that has been substantially changed."[160]

Judge Timbers next made an assessment of exactly what damages should be measured — the reduction in the appraisal value of CCI's Piper holdings attributable to BPC's ill-won victory in their takeover contest.[161] He further felt that since all of the defendants contributed in some measure to this victory through their violations of the securities laws, joint and several liability would be appropriate.[162] Little of this can seriously be criticized. An analysis of alternatives serves only to emphasize that the question of relief available for violations of section 14(e) is undoubtedly the most perplexing aspect of this section. The question of damages under section 14(e) is sure to plague the courts in the future, and the question will be doubly difficult due to the very nature of section 14(e) violations which are sure to differ greatly in every case. As a result, courts will be forced to fashion their own forms of relief, and particularly their own forms of damages, with little help from previous cases.

In examining the question of equitable relief, Judge Timbers felt that BPC should be denied the fruits of its illegal victory. He therefore directed the district court to include in its judgment an injunction barring BPC from voting the shares it obtained through its exchange offer, for a period of at least five years.[163] This instruction undercut the rationale behind Judge Friendly's dicta in *Electronic Specialty* wherein he flatly rejected permanent deprivation of voting rights as a viable form of relief.[164] He reasoned that deprivation of voting rights would be nothing more than "a disguised method of forcing divestiture," and that leaving the direction of an enterprise to 45% of the stock "would be decidedly unhealthy."[165] Judge Timbers found little

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[160] 480 F.2d at 379.

[161] *Id.* at 380.

[162] *Id.*

[163] *Id.*

[164] 409 F.2d at 947.

[165] *Id.* at 948.

merit in the latter assertion, and dealt with the former by imposing a temporary rather than a permanent injunction. Nonvoting stock is commonplace in today's corporate world. There are no inequalities inherent in the control of a corporation by minority financial interests. Abuse is far more likely in the normal structure of common and preferred classes. Manipulation by the voting common to the detriment of the nonvoting preferred is easily accomplished, whereas here the voting common could hardly affect the nonvoting common without equally affecting itself.[166]

The first objection that Judge Friendly had made to barring the voting rights of the victor — that it would be nothing more than an indirect method of forcing divestiture — would have been more of a problem were it not for Judge Timbers' use of a temporary restriction. Such a restriction should not cause a divestiture. Despite the lack of control, the investment might remain lucrative. The fact that the voting right will be restored in the future, and with it control, offers an even greater incentive to retain the stock. Moreover, even if the successful contender decides to divest, the option of waiting until the market favors disposal of a large number of the target's shares offers possible mitigating relief and greatly lessens the harm to innocent shareholders.[167] That Judge Timbers only deprived BPC of its voting right to the illegally obtained stock, approximately 7% of the outstanding shares of Piper, should serve to prevent any precipitous dumping of Piper stock.[168] Indeed, the apparently temperate impact of the remedy, together with its general flexibility, promises frequent use of this form of injunctive relief for future violations of section 14(e).

Ramifications of Chris-Craft

The court has, through its holdings in *Chris-Craft*, effectively opened the federal courts to suits brought by offerors against target companies. Although this is clearly a result the Williams Act was intended to effect, it appears that the Act has imposed a number of hardships on target companies seeking to defend against a takeover bid. This result would clearly be opposite that intended by the framers of the original act, who felt it was necessary to protect incumbent

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[166] *See* Note, *Cash Tender Offers, supra* note 11, at 402.

[167] *Id.*

[168] During the contest for control of Piper Aircraft there were 1,644,890 shares of Piper stock issued and outstanding. The culmination of the contest found BPC with 839,306 shares (51%). Of this amount 120,200 shares were purchased by BPC while awaiting SEC action on its exchange offer, a violation of rule 10b-6; and 111,628 shares were purchased by BPC through its exchange offer, the registration statement for which was found to be materially misleading. Thus, approximately 7% (233,828 shares) were purchased illegally and the voting rights to these shares were accordingly revoked for five years by Judge Timbers.

management from "corporate raiders"[169] and, to a lesser extent, would circumvent the intentions of Congress which desired a balanced law to provide both the offeror and management an equal opportunity to present their cases fairly.[170]

One of the most effective methods of fighting a tender offer is through communications of management's position to the shareholders. This is commonly accomplished through letters, advertisements in the press, personal contacts, and press releases. In the past, incumbent management has been in a unique position to create uncertainty as to the inadequacy of a tender offer price.[171] But now the standard argument of management — that the company's stock must be worth more if the offeror is willing to pay the offered price — has been irreparably damaged by the *Chris-Craft* ruling. Target companies will now be forced to justify, carefully, their statements to shareholders.

The full implications of this can not be recognized until several other factors are taken into account. A well known principle of the tender offer procedure is that "time is of-the-essence,"[172] both for the offeror and for the target. The target has only a short time to get its information and recommendations to the shareholders, and any delay at the offering stage can be disastrous. However, SEC rule 14D-4[173] requires that management file a schedule 14D[174] with the SEC before any affirmative action to combat the takeover attempt is taken. This schedule requires, among other things, a statement of the reasons behind the recommendation to accept or to reject the tender offer. The preparation of this document takes time, and effectively permits the offer to go unopposed for a period of time. Furthermore, the effect of *Chris-Craft* is to force incumbent management to disclose, in both the Schedule D statement and in communications to shareholders, material information which would have a detrimental effect on its defense. This would be so even if the information might appear disproportionately damaging in the eyes of the shareholders while, in fact, its long term effects on the company might be minimal. In the event that target management does not wish to communicate this information to its shareholders, its only alternative is not to make a recommendation at all. The result seems harsh, though unfortunately unavoidable.

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[169] *See* note 4 *supra.*

[170] 2 U.S. CODE NEWS, *supra* note 1, at 2813.

[171] Schmultz and Kelly, *Cash Take-Over Bids — Defense Tactics,* 23 BUS. LAW. 115, 121 (1967).

[172] *Id.* at 115.

[173] 17 C.F.R. § 240.14d-4 (1973).

[174] 17 C.F.R. § 240.14d-101 (1973).

At the same time that target management is faced with this communication problem, and is now so easily attacked by the offeror, the target has apparently not been given any additional basis for challenging the offeror. On the contrary, there seems less of a chance for the target to successfully challenge the takeover bid in court. Prior to the Williams Act there were no clear guidelines on what information a tender offeror should disclose in making his tender offer. As a result, targets were able to challenge offerors in court on the basis of alleged violations of rule 10b-5. While it is true that these suits, in the main, were not very successful, the courts did give the appearance of slowly coming around to recognizing the validity of this type of action.[175] The Williams Act limits the grounds upon which a target can challenge the offeror, since the disclosure requirements of the offeror are not difficult to meet, and if they are met, they severely confine the area that the target can attack.[176]

The *Chris-Craft* court attempted to balance these problems when it recognized that Piper's effort to avert the takeover by using the standard argument of management — that the company's stock must be worth more if the offeror is willing to pay the offered price — was a common response to such an action,[177] but, rather, that it was their failure to communicate all the material information (*i.e.*, the fact that their underwriters thought the offered price to be equitable) to their shareholders which constituted the violation of section 14(e). Nevertheless, the court has written an opinion under which the offeror faces fewer difficulties in completing a takeover attempt than might have initially been expected under the Williams Act. Though it is too soon to gauge what the effects will be on likely target companies, it does appear that the results may very well take a heretofore unexpected turn.

Conclusion

The legislative history clearly indicates that the purpose of the Williams Act was to close the "gap" in federal securities regulation. This "gap" was illuminated in the 1960's when the cash tender offer, for a number of reasons, became a preferred method of corporate acquistion. In *Christ-Craft* the Second Circuit Court of Appeals gave effect to the broad antifraud provisions of the Act. The court recognized that section 14(e) largely tracks rule 10b-5 and wisely chose to

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[175] *See* Butler Aviation Int'l, Inc. v. Comprehensive Designers, Inc., 307 F.Supp. 910, *aff'd*, 425 F.2d 842 (2d Cir. 1970). *See also* Crane Co. v. Westinghouse Air Brake Co., 419 F.2d 787 (2d Cir. 1969), *cert. denied*, 400 U.S. 822 (1970); *see generally* Lowenfels, *The Demise of the Birnbaum Doctrine: A New Era for Rule 10b-5*, 54 VA. L. REV. 268 (1968).

[176] Kennedy, *Defensive Take-Over Procedures Since the Williams Act*, 19 CATH. U. L. REV. 158, 175-76 (1969).

[177] 480 F.2d at 365.

pattern its decision primarily on substantive law under rule 10b-5. In so doing, the court has possibly put a burden on the target of a takeover attempt that the framers of the Act never intended.

In spite of this, the courts would be wise to continue concentrating on ensuring procedural fairness to all parties involved in a tender offer. In the event it appears that too great a burden has been placed on the target corporation, and the economics of the situation demand a rethinking of the regulations concerning takeovers, the legislature is the proper forum in which the review should take place. In such case, the legislature might give serious thought to policy considerations which would recognize that it is, after all, the target corporation and the nontendering shareholders who must be protected along with the tendering shareholders and the investing public at large.

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